LIBRARY
SUPREME COURT, U. S.

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, [redacted] 1961

No. [redacted] 60

GROVER D. TURNBOW, ET AL., PETITIONERS,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PETITION FOR CERTIORARI FILED MARCH 2, 1961
CERTIORARI GRANTED MAY 15, 1961

No. 16775

United States
Court of Appeals
for the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

GROVER D. TURNBOW and RUTH H. TURNBOW,
Respondents.

Transcript of Record

Petition to Review a Decision of The Tax Court of the United States

INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

	PAGE
Answer to Petition For Redetermination of Deficiency	22
Certificate of Clerk to Transcript of Record	50
Decision	43
Docket Entries	3
Findings of Fact and Opinion	29
Names and Addresses of Attorneys	1
Opinion	36
Petition For Redetermination of Deficiency	6
Notice of Deficiency	15
Petition For Review of Decision	44
Statement of Points To Be Relied Upon	52
Stipulation of Facts	24
Transcript of Proceedings (Excerpt)	27
Proceedings in United States Court of Appeals for the Ninth Circuit	54 54
Minute entry of argument and submission (omitted in printing)	54 54
Minute entry of order directing filing of opinion and filing and recording of judgment (omitted in printing)	55 54
Opinion, Merrill, J.	56 54
Judgment	67 65
Clerk's certificate (omitted in printing)	68 65
Order allowing certiorari	69 66

NAMES AND ADDRESSES OF ATTORNEYS

CHARLES K. RICE,
Assistant U. S. Attorney,

LEE A. JACKSON,
Attorney,

Department of Justice,
Washington 25, D. C.,

Attorneys for Petitioner.

M. W. DOBRZENSKY,
S. H. DOBRZENSKY,

1730 First Western Bank Bldg.,
Oakland 12, California,

Attorneys for Respondent.

Tax Court of the United States

Docket No. 69429

GROVER D. TURNBOW and RUTH H. TURNBOW, husband & wife, Petitioners.

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

DOCKET ENTRIES

1957

Aug. 19—Petition Filed: Fee Paid 8/19/57. Served Sept. 5, 1957.

Oct. 23—Answer by resp. filed. Served Oct. 29, 1957.

Oct. 23—Request by resp. for trial at San Francisco, California. Granted 10/24/57.

1958

Jan. 16—Motion by petr. for further and better statement.

Jan. 16—Motion by petr. for severance of an issue and a preliminary hearing on the issue.

Jan. 23—Notice of hearing Feb. 5, 1958, Wash. D. C. on petrs. motions of 1/16/58. Served Jan. 23, 1958.

Feb. 5—Hearing on petrs. motions for further and better statement and for severance of issues.

1958

Feb. 5—Order, that the motion for severance of issues is Denied and further, Order, that the hearing for further and better statements is continued to March 12, 1958, Wash. D. C., to permit Resp. to file amended answer. Served Feb. 10, 1958.

Feb. 10—Transcript of Proceedings, filed.

Feb. 21—Order, that Order of the Court of 2-5-58 is vacated and set aside and further Order, that petrs. motions for better statement and severance of issues are Denied.

June 27—Notice of Trial Oct. 6, 1958, San Francisco, Calif.

Oct. 10—Trial before J. Harron—San Francisco, California.
Stipulation of Facts filed at trial;
Original briefs due December 9, 1958
Reply briefs due January 9, 1959
Submitted to J. Harron—Under Submission.

Oct. 24—Transcript of Proceedings 10-10-58 filed.

Dec. 3—Motion by resp. for extension of time to file brief to Dec. 29, 1958, Granted, 12-5-58, Dates of briefs, P&R, due 12-29-58, Reply Briefs due 1/30/59, M. J. Harron, Judge.

Dec. 5—Brief for Petr filed. Served 1-13-59.

Dec. 29—Motion by resp. for extension to Jan. 12, 1959 to file brief. Granted 1-2-59.

1959

Jan. 12—Brief by resp. filed. Served 1-13-59.

1959

Jan. 30—Reply Brief filed by petr. Served Feb. 19, 1959.

June 12—Findings of Fact and Opinion filed Judge Harron. Served June 12, 1959. Decision will be entered under Rule 50.

July 10—Motion by resp. for extension of time to August 12, 1959 to file Motion for reconsideration. Granted 7-13-59. Served July 16, 1959.

Aug. 12—Motion by resp. for review by the full court. Denied 8-13-59. Served Aug. 14, 1959.

Aug. 12—Motion by resp. for reconsideration. Denied 8/17/59. Served Aug. 17, 1959.

Aug. 12—Memo. Brief by resp. in support of resp's motion for reconsideration. Served Aug. 14, 1959.

Aug. 27—Agreed Comp. Filed.

Aug. 31—Decision entered, Judge Harron. Served Sept. 1, 1959. Appellate Proceedings.

Nov. 18—Petition For Review by U.S.C.A. 9th Cir. filed by resp.

Dec. 14—Motion for extension of time to file record on rev. and docket pet. for rev. filed by resp.

Dec. 14—Order enlarging time for filing record on rev. and docketing pet. for rev. to Feb. 16, 1960. Served Dec. 15, 1959.

Dec. 15—Proof of Service of pet. for rev. on counsel filed.

Dec. 15—Proof of Service of pet. for rev. on petrs. filed.

1960

Jan. 29—Designation For Contents of Record On Rev., with proof of service thereon, filed by resp.

[Title of Tax Court and Cause.]

PETITION

The above named Petitioners hereby petition the above entitled Court for a redetermination of Respondent's determinations of items of alleged additional tax liability set forth in Respondent's notice of deficiency, dated May 28, 1957, and as the basis for their petition allege as follows:

1. Petitioners are Grover D. Turnbow and Ruth H. Turnbow, husband and wife, and their principal office is at No. 425 Battery Street, San Francisco, California, and their tax returns for the period in controversy (their taxable years ended December 31, 1952 and December 31, 1953) were filed in the office of the District Director of Internal Revenue at San Francisco, California.

2. The notice of deficiency (a copy of which is hereunto annexed) on which this Petition is based, was mailed to Petitioners on May 28, 1957.

3. The amount of the alleged deficiencies determined by Respondent are as follows:

Year	Nature of Tax	Amount
1952	Income Tax	$264,037.43
1953	Income Tax	14,786.26
		$278,823.69

4. The following is an assignment of each and every error which Petitioners are able to allege to have been committed by Respondent in the determinations of the aforesaid alleged deficiencies:

(a) None of the several determinations of items of alleged additional tax liability specified in the notice of deficiency is predicated on any basis in fact or in law which are or have been disclosed to Petitioners; and:

(i) said notice of deficiency denies Petitioners due process of law, as guaranteed to them by the Fifth Amendment to the United States Constitution; and

(ii) each of said determinations is violative of the principles set forth in Respondent's own regulation (C.F.R. Internal Revenue—1954, § 601.106 (f)(1)) that "an exaction by the United States Government which is not based on law, statutory or otherwise, is a taking of property without due process of law in violation of the Fifth Amendment to the United States Constitution" and that conclusions of fact and application of the law "shall hew to the law and the recognized standards of legal construction"; and

(iii) said notice of deficiency fails to comply with the standard declared by the Supreme Court of the United States in Helvering v. Tex-Penn Oil Co.,

300 U. S. 481, 498, that a taxpayer is entitled to know the basis of law and fact on which the Commissioner seeks to sustain his deficiencies; and

(iv) since the purpose of this proceeding is to enable this Court to redetermine the determinations made by Respondent, the failure of the notice of deficiency to disclose any bases in law or in fact for Respondent's determinations leaves this Court without any assistance from Respondent's said notice of deficiency in knowing, or considering, or evaluating the bases in law or in fact, if any, upon which Respondent's determinations are made; and

(v) since Petitioners have not been informed by Respondent in said deficiency notice or otherwise of any basis in law or in fact for Respondent's determinations, they are unable in this Petition either to set forth, or point out, specific errors in whatever bases in law or fact may have existed for Respondent's determinations; and

(vi) by reason of the premises aforesaid, each of said determinations of items of alleged additional tax liability is void for uncertainty.

(b) (i) Referring to Respondent's determination for 1952 of alleged additional income—"(b) net long term capital gain—$495,754.01": Respondent erred, in computing and determining and recognizing Petitioners' gain from their exchange in 1952 of their 5,000 shares of International Dairy Supply Co., a corporation, for 82,375 shares of capital stock of Foremost Dairies, Inc. plus $3,000,000 in cash, in

the sum of $4,163,691.94 and in failing and refusing to determine that, but for the receipt by Petitioners, in said exchange, of cash "boot" in said sum of $3,000,000,

—such exchange would have constituted a "reorganization" as defined by 1939 IRC §112(g)(1)(B); and

—no gain would have been recognized from such exchange under the provisions of 1939 IRC §112(b)(3); and

(ii) Respondent erred in valuing the Foremost stock at $15.00 per share; and

(iii) Respondent erred in failing to determine that but for the receipt by Petitioners in said exchange of said cash "boot" in the sum of $3,000,000 said exchange would be within the provisions of 1939 IRC §112(b)(3) and under 1939 IRC §112(c)(1) and that Petitioners' gain from such exchange should be recognized, in an amount not in excess of said $3,000,000 cash "boot"; and

(iv) Respondent erred in his recognition and computation of "Gain Recognized — $4,163,691.94" (which such amount is in excess of the amount of said cash "boot" received by Petitioners in said exchange); and

(v) Respondent erred in his computation and determination of "Additional Gain Recognized—$1,178,699.17" and in his "Adjustment to Income—50%—$589,349.59".

(c) Referring to Respondent's disallowance of the item "(c) Legal Fees—$1,148.66": Respondent erred

in disallowing said item of legal fees paid subsequent to the exchange of Petitioners' stock in International Dairy Supply Co. for stock of Foremost Dairies, Inc., plus cash, for advice and counsel respecting Petitioners' income tax liability for 1952, with respect to their gains resulting from such exchange and to assist them in reporting such gains for income tax purposes.

(d) Referring to the year 1953 and the item "Unallowable Deduction"—"(a)Depreciation on dam—$2,312.11": If the rate of "depreciation allowable 2%" means that Respondent determined that the economically useful life of the earthen dam is 50 years, Respondent erred in determining that said earthen dam had an economically useful life in excess of 20 years and in determining that the rate of depreciation thereof was 2%.

(e) Referring to the year 1953 and to the item "Unallowable Deductions"—"(d) Legal Fees—$1,500.00": Respondent erred in disallowing this item of expense which was paid by Petitioners for legal counsel and advice with respect to Petitioners' income tax liability for 1952 and to assist them in reporting their gains for 1952 for income tax purposes.

5. Following are the facts upon which Petitioners rely as sustaining the foregoing assignments of error:

(a) (i) Respondent has failed to specify any bases in law or in fact for his several determinations of alleged items of additional tax liability of Petitioners for said calendar years 1952 and 1953 and

denies Petitioners due process of law in this,—that Respondent has not advised Petitioners of the bases in law and in fact upon which Respondent made his determinations of alleged items of additional tax liability and Petitioners do not know upon what bases in law or in fact, if any, said determinations of items of alleged additional tax liability may have been made, and it is therefore impossible for Petitioners in this Petition to comply with the Court's Rule which requires them in this Petition to set forth clear and concise assignment of each and every error committed by Respondent in the determinations of alleged items of deficiency.

(ii) Respondent's determinations of items of alleged tax deficiency for each of said taxable years is void for uncertainty for failing to state any bases in law or in fact for any of said determinations.

(b) (i) In 1952 Petitioners were the owners of all (viz. 5,000 shares) of the issued and outstanding shares of voting capital stock of all classes of International Dairy Supply Co., a corporation, hereinafter called International.

(ii) In 1952, Petitioners exchanged their said 5,000 shares of International with Foremost Dairies, Inc., a corporation, hereinafter called Foremost, for 82,375 shares of the voting capital stock of Foremost plus cash "boot" in the sum of $3,000,000.

(iii) Said exchange between Petitioners and Foremost was made under and pursuant to a plan of reorganization.

(iv) In said exchange, Foremost acquired all of

the issued and outstanding shares of the capital stock of all classes of International.

(v) But for the payment by Foremost to Petitioners, and their receipt, of said cash "boot" in the sum of $3,000,000 in said exchange, said exchange would have been an exchange of Petitioners' said voting stock in International solely for said voting stock of Foremost, and Foremost, in said exchange, would have acquired all of the issued and outstanding shares of the voting capital stock of International solely in exchange for said 82,375 shares of Foremost's voting stock.

(vi) The fair market value of the Foremost stock received by Petitioners, on the day the exchange was consummated, was $14.50 per share.

(vii) Petitioners' recognizable gain upon said exchange was $2,984,992.77.

(c) In 1953 Petitioners were and they are now the owners of Pomponio Ranch situated in San Mateo County, California. In 1953, in order to conserve and utilize for irrigation purposes rain waters on said ranch, Petitioners constructed an earthen dam with which to impound said water. Said dam impounds the headwater of Pomponio Creek for a drainage area of approximately 300 acres and has a storage capacity of approximately 265 acre feet. Said ranch and the dam site and the area in the rear thereof lies in the midst of steep hilly land, close to the Pacific Ocean, in an area of high rainfall and the soil in said ranch over which rain water impounded behind said dam drains and flows is a residual (silty-loam) type and lies atop clay, bedrock and shale and disintegrates rapidly

when impregnated with water and said soil has a very high erosive index. That by reason of the facts, the area behind said dam will become silted up, which will render said dam economically useless in a period not exceeding 20 years and the economically useful life of said dam will not exceed 20 years.

(d) In 1952, and after the consummation of the exchange referred to in the preceding paragraph (b)(2), Petitioners paid legal fees in the sum of $1,148.66 for legal counsel and advice with respect to the taxability of their gain from such exchange and to assist them in reporting said gain for tax purposes.

(e) In 1953 Petitioners paid legal fees in the sum of $1,500.00 for legal advice and counsel with respect to their tax liabilities on account of gains derived from their business transactions in 1952 and to assist them in reporting said gains for tax purposes.

Wherefore, Petitioners pray that this Court shall redetermine Petitioners' tax liability for said two years and

(a) Determine that Respondent's determinations of items of alleged additional tax liability for each of 1952 and 1953 were void for uncertainty in that each such determination denied Petitioners due process of law in failing to state any bases in fact or in law for any of such determinations.

(b) Determine that but for the receipt by Petitioners of $3,000,000 in cash "boot" in Petitioners'

exchange of their 5,000 shares of International for 82,375 shares of Foremost

(i) No gain or loss would have been recognized from said exchange under 1939 IRC §112(b)(3);

(ii) Said exchange would constitute "a reorganization" as defined by 1939 IRC §112(g)(1)(B);

(iii) Said exchange would be within the provisions of said §112(b)(3) if it were not for the fact that Petitioners, in said exchange, in addition to said 82,375 shares of Foremost received from Foremost said cash "boot" of $3,000,000;

(iv) Determine that Petitioners' gain from said exchange should be recognized in an amount not exceeding such cash "boot", viz. in a sum not in excess of $2,984,992.77.

(c) Determine that Respondent erred in disallowing the item "(c) Legal Fees—$1,148.66" for 1952.

(d) Determine that the economically useful life of the earthen dam on Pomponio Ranch was twenty (20) years and that proper rate for the depreciation thereof is 5%.

(e) Determine that Respondent erred in disallowing the item "(d) Legal Fees—$1,500.00" for 1953.

(f) Grant Petitioners such other and further relief as shall be meet and proper in the premises.

Dated: August 13, 1957.

/s/ M. W. DOBRZENSKY,
/s/ S. H. DOBRZENSKY,
Attorneys for Petitioners.

Duly Verified.

Form 1230 (App.)

U. S. Treasury Department
Internal Revenue Service
Regional Commissioner

Appellate Division—San Francisco Region
San Francisco 2, California

In Replying Refer to
Ap:SF:AA:MHB
90-D:CWB

May 28, 1957

Mr. Grover D. Turnbow and
Mrs. Ruth H. Turnbow
Husband and Wife
425 Battery Street
San Francisco, California

Dear Mr. and Mrs. Turnbow:

You are advised that the determination of your income tax liability for the taxable year(s) ended December 31, 1952 and December 31, 1953 discloses a deficiency or deficiencies of $278,823.69, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you

may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays, and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Assistant Regional Commissioner, Appellate, Room 1010, 870 Market Street, San Francisco 2. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is the earlier.

Very truly yours,

RUSSELL C. HARRINGTON
Commissioner,

By .....
Special Assistant
Appellate Division

Enclosures:

Statement
IRS Pub. 160
Agreement Form
SF - 4130

Ap:SF:AA:MHB
90-D:CWB

STATEMENT

Mr. Grover D. Turnbow and
Mrs. Ruth H. Turnbow
Husband and Wife
125 Battery Street
San Francisco, California

Tax Liability for the Taxable Years Ended December 31, 1952, and December 31, 1953.

Year		Deficiency
1952	Income Tax	$264,037.13
1953	Income Tax	14,786.26
Total		$278,823.69

In making this determination of your income tax liability, careful consideration has been given to your protest dated November 19, 1956, and to the statements made at the conference held on February 19, 1957.

A copy of this letter and statement has been mailed to your representatives, Mr. M. W. Dobrzensky, 1516 First Western Bank Building, Oakland 12, California and Mr. H. E. Alber, c/o Arthur Young and Co., 120 Montgomery Street, San Francisco, California, in accordance with the authority contained in the power of attorney executed by you.

Adjustments to Income
Year: 1952

Net income as disclosed by return		$1,610,718.16
Unallowable deductions and additional income:		
(a) Loss from business	$ 16,710.15	
(b) Net long-term capital gain	495,754.01	
(c) Legal fees	1,148.66	513,613.12
Net income as adjusted		$2,124,391.28

Explanation of Adjustments

(a) Your reported income is increased $16,710.15, representing the total of unallowable depreciation and expenses, as shown below:

Explanation of Adjustments—(Continued)

Pomponio Ranch:		
Legal expense	$ 312.49	
Repairs	2,800.00	
Depreciation	6,400.35	$ 9,512.84
Bakersfield Ranch:		
Depreciation		7,227.61
Total unallowable deductions		$ 16,740.45

(b) 1. In 1952 you exchanged 5,000 shares of International Dairy Supply Company capital stock for $3,000,000.00 in cash and 82,375 shares of capital stock of Foremost Dairies, Inc. You determined that the gain to be recognized was limited to the amount of cash received. In your return you reported a gain of $2,984,992.77 ($3,000,000.00 less $15,007.23 expense of exchange). It is held that the entire gain realized upon the exchange constituted taxable income. The adjustment to the income reported in your return is computed as follows:

Amount received on exchange:		
Cash		$3,000,000.00
82,375 shares of Foremost Dairies, Inc. valued at $15.00 a share		1,235,625.00
Total received		$4,235,625.00
Less: Basis of stock exchanged	$50,000.00	
Expenses per return	20,981.80	
*Add'l legal fees allowed	951.26	71,933.06
Gain recognized		$4,163,691.94
Gain reported		2,984,992.77
Additional gain recognized		$1,178,699.17
Adjustment to income—50%		$ 589,349.59

* 2. In your return you claimed a deduction in the amount of $1,148.56 for legal fees. It is held that these fees were not ordinary and necessary expenses incurred in connection with your business, but were expenses incurred in connection with the exchanges of stock. The deduction claimed is, accordingly, disallowed, and $951.26, the amount allocable to the exchange of your stock in International Dairy Supply Company, is allowed as a deduction in computing the gain on the exchange.

3. In your return you reported long-term capital gain in the amount of $189,786.00 from the sale of 13,100 shares of capital stock of Foremost Dairies, Inc. In computing the gain reported on the sale you used $6,795.00 as the basis of 10,000 shares and $2,718.00 as the basis of 3,100 shares, or a total basis of $9,513.00. In computing the gain on the exchange of your stock of International Dairy Supply Company for cash and stock of Foremost Dairies, Inc., the stock of Foremost Dairies was valued at $15.00 a share.

In conformity with the value used in computing the gain on the exchange $15.00 a share is allowed as the basis for determining the gain realized from the sale of Foremost Dairies, Inc. As a result of this adjustment, the capital gain reported on the sale of Foremost Dairies, Inc., stock is decreased by $186,987.00, as computed below:

Basis of 13,100 shares at $15.00 a share	$ 196,500.00
Less: Basis claimed in return	9,513.00
Decrease in capital gain reported	$ 186,987.00
Decrease in taxable income—50%	$ 93,493.50

4. It is determined that you are entitled to a capital loss carryover, after limitation, in the amount of $208.77 instead of $106.69, as shown in your return. Your reported net gain is, accordingly, reduced $102.08.

The adjustments shown as (b) 1. through 4. result in a net increase in your reported long-term capital gain in the amount of $495,754.01.

(c) This adjustment has been previously explained in paragraph (b) 2.

Computation of Tax
Year: 1952

Net income as adjusted	$2,124,391.28
Less: Exemptions	1,200.00
Income subject to tax	$2,123,191.28
One-half of such income	$1,061,595.64
Less: One-half of excess of net long-term capital gain over net short-term capital loss	1,049,466.07

Computation of Tax—(Continued)

Balance subject to tax		$ 12,129.57
Tax on $12,129.57		$ 3,858.19
Partial tax—$3,858.19 times 2		$ 7,716.38
Add: 104 percent of $1,049,466.07		1,091,444.71
Income tax liability		$1,099,161.09
Liability disclosed by return:		
Original Account No. BR 701100		835,123.66
Deficiency		$ 264,037.43

Adjustments to Income
Year: 1953

Net income as disclosed by return		$ 77,375.15
Unallowable deductions and additional income:		
(a) Depreciation on dam	$ 2,312.11	
(b) Loss from business	19,041.52	
(c) Taxes	400.00	
(d) Legal fees	1,500.00	$ 23,253.63
Total		$ 100,628.78
Nontaxable income and additional deductions:		
(e) Net long-term capital gain		2,438.24
Net income as adjusted		$ 98,190.54

Explanation of Adjustments

(a) In your return you claimed a deduction of $2,890 for depreciation on an earthen dam completed in 1953 at a cost of $57,828.57. It is held that 2% a year is a reasonable allowance for depreciation on the dam. The income reported in your return is adjusted as follows:

Depreciation claimed	$ 2,890.40
Depreciation allowable 2% of $57,828.57 for 6 months	578.29
Depreciation disallowed	$ 2,312.11

(b) Your reported income is increased $19,041.52, representing the total of unallowable depreciation and expenses, as shown below:

Explanation of Adjustments—(Continued)

Pomponio Ranch:		
Repairs	$ 6,492.96	
Depreciation	6,289.43	$ 12,782.39
Bakersfield Ranch:		
Depreciation		6,259.13
Total unallowable deductions		$ 19,041.52

(c) It is determined that the allowable deduction from real estate taxes assessed by the City of Piedmont, California is $1,357.30 instead of $1,757.30 as claimed in your return. Your reported income is, accordingly, increased $400.00.

(d) In your return you claimed a deduction of $1,500.00 for legal fees. It is held that these fees were not ordinary and necessary expenses incurred in connection with your business, but were expenses incurred in connection with the exchanges of stock. The deduction claimed is, accordingly, disallowed, and $1,242.33, the amount allocable to taxable exchanges, is allowed as a deduction in computing your capital gain for the taxable year.

(e) 1. It is determined that sales within the year of two cotton pickers resulted in a total net long-term capital gain of $1,097.71 instead of $2,914.78 as shown in your return. Your reported gain is, therefore, reduced $1,817.07.

2. As stated in paragraph (d), above, $1,242.33 ($621.17 after limitation) of legal fees paid is allocable to taxable exchanges and is allowed as a deduction in the computation of net long-term capital gain.

The total of these adjustments reduces your reported net long-term capital gain in the amount of $2,438.24.

Computation of Tax
Year: 1953

Net income as adjusted		$ 98,190.54
Less: Exemption		1,200.00
Income subject to tax		$ 96,990.54
One-half of such income		$ 48,495.27
Less: One-half of excess of net long-term capital gain over net short-term capital loss		6,952.96

Computation of Tax—(Continued)

Balance subject to tax	$	41,542.31
Tax on $41,542.31	$	22,646.46
Partial tax—$22,646.46 times 2	$	45,292.92
Add: 104 percent of $6,952.96		7,231.08
Income tax liability	$	52,524.00
Liability disclosed by return:		
Original account No. AC 163		37,737.74
Deficiency	$	14,786.26

Served and Entered September 5, 1957.

[Endorsed]: T.C.U.S. Filed August 19, 1957.

[Title of Tax Court and Cause.]

ANSWER

The Respondent, in answer to the petition filed in the above-entitled proceeding, admits and denies as follows:

1, 2, and 3. Admits the allegations in paragraphs 1, 2, and 3.

4. Denies that the Commissioner erred in the determination of the deficiency as alleged in paragraph 4 and in each and every subparagraph and subdivision thereunder.

5. (a)(i) and (ii) Denies the allegations in subparagraphs (a)(i) and (ii) of paragraph 5.

(b)(i) and (ii) Admits the allegations in subparagraphs (b)(i) and (ii) of paragraph 5.

(b)(iii) Denies the allegations in subparagraphs (b)(iii) of paragraph 5.

(b)(iv) Admits the allegations in subparagraphs (b)(iv) of paragraph 5.

(b)(v),(vi), and (vii) Denies the allegations in subparagraphs (b)(v),(vi), and (vii) of paragraph 5.

(c) Admits the first sentence of subparagraph (c) of paragraph 5; for lack of information, denies the remaining allegations.

(d) Admits that in 1952, and after the consummation of the exchange referred to in the preceding paragraph (b)(2), petitioners paid legal fees in the sum of $1,148.66 for legal counsel; denies the remaining allegations in subparagraph (d) of paragraph 5.

(e) Admits that in 1953 petitioners paid legal fees in the sum of $1,500.00 for legal advice and counsel; denies the remaining allegations in subparagraph (e) of paragraph 5.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the Commissioner's determination in all respects be approved and the appeal denied.

/s/ NELSON P. ROSE, JM
Chief Counsel, Internal
Revenue Service.

Of Counsel: Melvin L. Sears, Regional Counsel, Nat F. Richardson, Attorney, Internal Revenue Service, 1069 Flood Building, San Francisco 2, Calif.

Served and Entered October 29, 1957.

[Endorsed]: T.C.U.S. Filed October 23, 1957.

[Title of Tax Court and Cause.]

STIPULATION OF FACTS

It Is Hereby Stipulated and Agreed by and between the Commissioner of Internal Revenue and the above named taxpayer, by and through their respective attorneys, that the following facts should be taken as true, provided, however, that this stipulation does not waive the right of either party to introduce other evidence not at variance with the facts herein stipulated, or to object to the introduction in evidence of any such facts on the grounds of immateriality or irrelevancy:

1. Petitioners are Grover D. Turnbow and Ruth H. Turnbow, husband and wife, and their prin-

cipal office is at No. 425 Battery Street, San Francisco, California, and their tax returns for the period in controversy (their taxable years ended December 31, 1952 and December 31, 1953) were filed in the office of the District Director of Internal Revenue at San Francisco, California.

2. The notice of deficiency was mailed to Petitioners on May 28, 1957. A true copy of said notice is annexed to Petitioners' Petition in these proceedings and the same is incorporated in this Stipulation, by this reference, as if set out fully at length herein.

3. The amount of the alleged deficiencies determined by Respondent are as follows:

Year	Nature of Tax	Amount
1952	Income Tax	$261,037.43
1953	Income Tax	11,786.26
		$278,823.69

4. The items "(c) Legal Fees—$1,148.66," disallowed for the year 1952, and the item "(d) Legal Fees—$1,500.00," disallowed for the year 1953, each represent items of expense paid by Petitioners for legal counsel and advice with respect to Petitioners' income tax liability for 1952 and to assist them in reporting such gains for income tax purposes.

5. In 1952 Petitioners were the owners of all (viz., 5,000 shares) of the issued and outstanding shares of voting capital stock of all classes of International Dairy Supply Co., a corporation, hereinafter called International.

6. In 1952, Petitioners exchanged their said 5,000 shares of International with Foremost Dairies, Inc., a corporation hereinafter called Foremost, for 82,375 shares of the voting capital stock of Foremost plus cash "boot" in the sum of $3,000,000, less the expenses of such transfer in the sum of $15,007.23, so that Petitioners received, as said "boot" the net sum of $2,984,992.77.

7. Prior to the time of said exchange of shares and cash, Petitioners, International Dairy Supply Co. and Foremost Dairies, Inc. had executed an agreement, entitled "Amendatory Agreement," bearing date of February 11, 1952, a true copy of which agreement is marked Exhibit I, annexed hereto, and by this reference incorporated in this Stipulation as if set out fully at length herein. Said Amendatory Agreement provides for the exchange by Petitioners of their said 5,000 shares of International with Foremost, for 82,375 shares of the capital stock of Foremost plus cash "boot" in the amount hereinabove referred to.

8. The exchange provided for in said agreement was consummated on March 3, 1952.

9. In said exchange, Foremost acquired all of the issued and outstanding shares of the capital stock of all classes of International.

10. In said exchange, Petitioners acquired only said shares of Foremost and said cash "boot" and Foremost acquired only all of the issued and outstanding shares of the voting capital stock of International.

11. Said 82,375 shares of the capital stock of Foremost, on the date of the consummation of said exchange, had a fair market value of $15.00 per share.

12. The economic, useful life of the earthen dam situated on Petitioners' Pomponio Ranch in San Mateo County, California, completed on December 31, 1952, is 40 years.

Dated: October 10, 1958.

/s/ M. W. DOBRZENSKY,
/s/ S. H. DOBRZENSKY,
Attorneys for Petitioners.

/s/ ARCH M. CANTRALL, CMN
Chief Counsel,
Attorneys for Respondent.

[Endorsed]: T.C.U.S. Filed October 10, 1958.

[Title of Tax Court and Cause.]

TRANSCRIPT OF PROCEEDINGS

Customs Courtroom, 421 U. S. Appraisers Building, 630 Sansome Street, San Francisco, California. Friday, October 10, 1958.

The above-entitled matter came on for hearing pursuant to Call of the Calendar, at 9:45 o'clock a.m.

Before: The Honorable Marion J. Harron.

• • • • •

Opening Statement on Behalf of the Petitioners by Mr. S. H. Dobrzensky

Mr. S. H. Dobrzensky: As your Honor has already indicated, the case originally involved three issues: The depreciation on the dam, the legal fees, and the gain question, the deficiency proposed, which, as your Honor has already noted, and the years in question.

The sole remaining point of controversy is the question of the taxability of shares of stock received in a boot transaction, it being the contention of Respondent that the total consideration of shares, plus the cash boot, constituted taxable gain. The question of the deductibility of the aggregate of fees we have already disposed of, I think, by your Honor's questions.

The same is true with respect to the depreciation of the dam.

Since all of the facts on the question of the taxability of the exchange are stipulated, that issue is purely a legal one that can be argued in the briefs without the necessity of the introduction of any further evidence; that is, upon the filing of the stipulation.

* * * * *

[Endorsed]: T.C.U.S. Filed October 24, 1958.

32 T. C. No. 57

Tax Court of the United States

Grover D. Turnbow and Ruth H. Turnbow, Petitioners, v. Commissioner of Internal Revenue, Respondent.

Docket No. 69429. Filed June 12, 1959.

FINDINGS OF FACT AND OPINION

Petitioner, who owned all of the stock of Supply, exchanged all of such stock for shares of stock of Foremost Dairies, Inc., and $3,000,000. He reported gain limited to $3,000,000, less expenses, under section 112(c)(1), 1939 Code. Respondent determined that gain in excess of $3,000,000 was taxable because section 112(c)(1) was not applicable. Held, the provisions of section 112(c)(1) are applicable and petitioner's gain is recognized but only in an amount which does not exceed the cash payment.

M. W. Dobrzensky, Esq., and S. H. Dobrzensky, Esq., for the petitioners.

Nat. F. Richardson, Esq., for the respondent.

The Commissioner determined deficiencies in income tax for the taxable years 1952 and 1953 in the amounts of $264,037.43 and $14,786.26, respectively. The question is whether or not section 112 (c)(1), 1939 Code, applies to a transaction in which petitioner received cash and stock in an acquiring corporation in exchange for all of the stock in another corporation, which became a subsidiary of

the acquiring corporation, so that the taxable gain to be recognized is limited to the amount of cash received.

Findings of Fact

The petitioners, residents of San Francisco, California, filed joint income tax returns for the taxable years with the collector of internal revenue for the first district of California. Since the issue to be decided relates only to Grover D. Turnbow, he is referred to hereinafter as the petitioner.

Petitioner owned all of the outstanding stock of International Dairy Supply Co. (a Nevada corporation) and International Dairy Engineering Co. (a California corporation). International Dairy Supply Co. (a Nevada corporation) owned 60 per cent of the stock of Diamond Dairy, Inc., and a group of individuals represented by petitioner owned the remaining 40 per cent of the stock of Diamond Dairy, Inc.

Foremost Dairies, Inc., a New York corporation (hereinafter called Foremost), which has its principal place of business in Jacksonville, Florida, is engaged in the business of processing and distributing milk, cream, and other dairy products.

International Dairy Supply Co. (hereinafter called Supply[1]) had, and still has, its principal office in San Francisco. The main part of its business was furnishing reconstituted milk and

[1] The parties also refer to this corporation as International.

milk products to the Armed Forces of the United States, located outside the country, under contracts with the United States. Supply prepared dehydrated milk and milk products in this country and shipped such products to plants, which it operated in foreign countries, where the dehydrated milk and milk products were converted into liquid milk, chocolate drinks, ice cream, and similar products. Since it began business, 95 per cent of Supply's gross income has been derived from sources other than sources within the United States. In 1952, Supply was a party to a contract with the United States which had been executed in 1948 and which was a continuing contract in good standing. Supply also had a contract with the United States to furnish milk products to the Armed Forces in the Far East Command.

In 1952, there was only one class of stock of Supply issued, namely, voting capital stock. There were 5,000 shares outstanding, all of which were owned by Grover D. Turnbow.

In 1952, International Dairy Engineering Co. (hereinafter called Engineering) was engaged in constructing a plant at Atwater, California. Its total outstanding stock consisted of 100 shares, which were owned by Turnbow.

In 1952, the outstanding capital stock of Diamond Dairy, Inc. (hereinafter called Diamond) consisted of 25,000 snares, of which Supply owned 15,000 shares, 60 per cent, and individuals owned 10,000 shares, 40 per cent.

In 1951, Foremost and Turnbow began negotiations and entered into an agreement under which Foremost was to acquire all of the stock of the three corporations above named in what was intended to be a tax-free reorganization. Upon completion of preliminary matters in the early part of 1952, a supplemental agreement, called "Amendatory Agreement," was executed by Foremost and Turnbow on February 11, 1952. The amendatory agreement is incorporated herein by this reference. It included, inter alia, the reorganization plan.

Under the reorganization plan the following was to be done: (1) Foremost was to acquire from Turnbow all of the capital stock of Supply (5,000 shares), and Turnbow was to receive in exchange 82,375 shares of the common stock of Foremost, plus $3,000,000. Supply was thereby to become a wholly owned subsidiary of Foremost; it was to continue in the operation of its business. (2) Foremost was to acquire from Turnbow all of the outstanding capital stock of International Dairy Engineering Co. (100 shares), and Turnbow was to receive in exchange 60,000 shares of the common stock of Foremost. International Engineering was thereby to become a wholly owned subsidiary of Foremost, and it was to continue in the operation of its business. (3) Under the first exchange of stock, Foremost would gain control of 60 per cent of the capital stock of Diamond Dairy, Inc., which was owned by Supply. Having acquired control of Diamond, Foremost, pursuant to the plan of reorganization, was to acquire the minority stock of

Diamond, 10,000 shares, by giving 10,000 shares of Foremost common stock in exchange for 10,000 shares of capital stock of Diamond, which Turnbow agreed to deliver. Neither Supply, Engineering, Diamond, nor Foremost was to make any distribution to its respective shareholders in pursuance of the plan of reorganization, or otherwise.

It was contemplated, under the reorganization plan, that the number of directors of Supply and Engineering would be changed so that Turnbow would maintain three directors thereon and Foremost would elect three directors; that Supply would create an executive committee consisting of three members, two of which would be nominated by Foremost: that Turnbow would be the president and general manager of Supply and Engineering, and that Turnbow's nominee would be president and/or general manager of Diamond; that Turnbow's salary would be in the same amount as the salary of the president of Foremost; that the president of Foremost might become the vice-president of Supply and of Engineering, and the chairman of the executive committee of each company; that Turnbow would become a member of the board of directors and of the executive committee of Foremost, and would have the right to nominate two directors, in addition to himself, to Foremost's board of directors; that Turnbow would be elected chairman of Foremost's executive committee; and that Turnbow would execute a formal agreement with Foremost not to compete with either Supply, Engineering, or Foremost in the type of business

carried on by each, other than the business of farming, cattle raising, or the farm production of milk. Furthermore, it was contemplated by the parties that there would be two divisions of the business of Foremost, the Eastern division, and the Western and International division; and that Turnbow would be known as the general manager of the Western and International division, and Paul E. Reinhold (the president of Foremost) would be known as the general manager of the Eastern division.

The closing date under the 1952 agreement was March 3, 1952. Prior to the closing dated Turnbow was to do the following things: He was to purchase a ranch and certain personal property for cash from Engineering, and he was to convey all title to a patent application to Engineering. Also, he was to pay $500,000 to Engineering as a capital contribution, and it was agreed that the plant which Engineering was constructing at Atwater would cost in excess of $600,000, and would be completed, substantially, by April 15, 1952. Turnbow was, further, to purchase for cash from Supply certain notes receivable of three stockholders of Diamond for $61,142, and a note of a Dr. Kempf for $3,150.

The terms of the agreement of February 11, 1952, were carried out.

On March 3, 1952, the exchange of the stock of Supply for stock of Foremost was consummated, and Turnbow received 82,375 shares of the common stock of Foremost (a minority interest) in exchange for all of the capital stock of Supply. Turnbow

also received cash from Foremost in the amount of $3,000,000. Since his expenses in connection with the exchange were $15,007.23, the net amount of the cash he received was $2,984,992.77.

On March 3, 1952, the 83,375 shares of common stock of Foremost had a fair market value of $15 per share.

In the exchange of the stock of Supply, Foremost acquired all of the issued and outstanding shares of stock of Supply, of all classes. In the exchange, petitioner acquired only the 82,375 shares of common stock of Foremost and cash in the amount of $3,000,000 ("boot"), and Foremost acquired only all of the issued and outstanding shares of the voting capital stock of Supply.

In the income tax return of the petitioner for 1952, he reported long-term capital gain from the above-described transaction in the amount of $2,984,992.77, under the provisions of sections 112(b)(3) and 112(c)(1).

The Commissioner's determination was as follows:

In 1952 you exchanged 5,000 shares of International Dairy Supply Company capital stock for $3,000,000.00 in cash and 82,375 shares of capital stock of Foremost Dairies, Inc. You determined that the gain to be recognized was limited to the amount of cash received. In your return you reported a gain of $2,984,992.77 ($3,000,000.00 less $15,007.23 expense of exchange). It is held that the entire gain realized upon the exchange constituted

taxable income. The adjustment to the income reported in your return is computed as follows:

Amount received on exchange:		
Cash		$3,000,000.00
82,375 shares of Foremost Dairies, Inc. valued at $15.00 a share		1,235,625.00
Total received		$4,235,625.00
Less: Basis of stock exchanged	$50,000.00	
Expenses per return	20,981.80	
Add'l legal fees allowed	951.26	71,933.06
Gain recognized		$4,163,691.94
Gain reported		2,984,992.77
Additional gain recognized		$1,178,699.17
Adjustment to income—50 percent		$ 589,349.59

Opinion

Harron, Judge: Petitioner owned all of the outstanding stock of Supply, which was voting stock. In 1952, he received in exchange for all of his stock in Supply 82,375 shares of common stock of Foremost and $3,000,000 in cash, so-called "boot." The question before us is limited to whether the provisions of section 112(c)(1) of the 1939 Code[2]

[2] Sec. 112(c) Gain From Exchanges Not Solely in Kind.—

(1) If an exchange would be within the provisions of subsection (b)(1), (2), (3), or (5), or within the provisions of subsection (1), of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph or by subsection (1) to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and and the fair market value of such other property.

apply to the transaction. Respondent has determined that section 112(c)(1) does not apply and, that therefore, the entire gain is taxable under section 112(a).

Petitioner contends that, in considering whether section 112(c)(1) applies to the transaction, it is necessary and proper to look to section 112(b)(3)[3] after omitting the cash payment involved in the transaction. Respondent contends that there must be a qualifying reorganization within the meaning of section 112(g)(1)(B)[4] before section 112(c)(1) can come into play insofar as section 112(c)(1) refers to an exchange within the provisions of section 112(b)(3).

---

[3] Sec. 112. Recognition of Gain or Loss.

(a) General Rule.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) Exchanges Solely In Kind.—

* * * * *

(3) Stock for stock on reorganization.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

[4] Sec. 112(g) Definition of Reorganization.—As used in this section * * *.—

(1) The term "reorganization" means * * *, or (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, * * *.

Subsection (b) of section 112 allows various exceptions from subsection (a), which states the general rule that the entire amount of the gain shall be recognized upon the sale or exchange of property. Subsection (b) deals with exchanges solely in kind, whereas subsection (c) deals with the treatment of gain from exchanges which are not solely in kind, but only if an exchange would be within (1), (2), (3), or (5), if it were not for the fact that the property received in exchange consists not only of property permitted by (1), or (2), or (3), or (5), but also of other property on money. Directing our attention to section 112(b)(3), it is noted that among the requirements contained therein is the specification that the property involved must be stock or securities which is exchanged solely for stock or securities. Both of the sections involved here, subsection (b)(3) and subsection (c)(1), are provisions of long standing which were reenacted in the successive revenue acts which preceded the 1939 Code. In both the regulations of the Commissioner and in this Court's interpretation of section 112(c)(1), it has been understood that in order to give effect to the provisions of section 112(c)(1) the method to be followed is first to omit the item of cash (or other property) from the transaction and then to determine whether the exchange would be within subsection (b)(3). Otherwise, section 112(c)(1) would have no meaning in the context of its references to particular subsections of section 112(b).

In Luther Bonham, 33 B.T.A. 1100, 1103-4 (1936),

this Court concluded that the method of applying the statute was as follows:

* * * It is necessary therefore to determine whether or not the exchange of * * * stock for * * * stock would be within the provisions of subsection (b)(3) if the item of cash had been omitted and only * * * stock had been received in exchange for * * * stock. (Underscoring supplied.)

In Howard v. Commissioner, 238 F. 2d 943, 948 (1956), reversing 24 T.C. 792, on the basis of a question which was not reached by this Court, the following was stated:

Thus we may conclude that, in determining when these so-called "boot" provisions apply, Congress intended that the transaction is to be considered separately and apart from the "boot" received in determining whether it meets the nonrecognition provisions. If the transaction, absent from the "other property or money," fulfills the requirements of section 112(b)(3), then gain is to be recognized to the extent that "boot" is received.

In the instant case, but for the cash received in exchange for * * * common stock of Binkley, the transaction would have met the "solely" requirement of section 112(g)(1)(B) and fallen within the scope of section 112(b)(3). To the extent that "boot" was received, gain would be recognized under our interpretation of section 112(c)(1). * * *

The view expressed in Howard v. Commissioner, supra, corresponds with the opinion which was expressed by this Court in the Bonham case. Our

problem here is whether we should adhere to our understanding of the method to be followed in determining whether section 112(c)(1) applies in an exchange of stock solely for stock, plus money.

Consideration has been given to the respondent's regulation, Regs. 118, sec. 39.112(g)-4 (issued September 26, 1953, and applicable to taxable years beginning after December 31, 1951), which is set forth in the margin.[3] Regs. 111, sec. 29.112(g)-4

---

[3] Sec. 39.112(g)-4 Exchanges in reorganization for stock or securities and other property or money.

(a) If in an exchange of stock or securities in a corporation a party to a reorganization, in pursuance of the plan of reorganization, for stock or securities in the same corporation or in another corporation a party to the reorganization, there is received by the taxpayer other property (not permitted to be received without the recognition of gain) or money, then

(1) As provided in section 112(c)(1), the gain, if any, to the taxpayer will be recognized in an amount not in excess of the sum of money and the fair market value of the other property, but

(2) The loss, if any, to the taxpayer from such an exchange is not to be recognized to any extent (see section 112(c)).

(b) The application of paragraph (a) of this section may be illustrated by the following example:

Example. A, in connection with a reorganization, in 1952, exchanges a share of stock in the X Corporation purchased in 1929 at a cost of $100 for a share of stock of the Y Corporation (a party to the reorganization), which has a fair market value of $90, plus $20 in cash. The gain from the transaction is $10 and is recognized and taxed as a gain from the exchange of property. But see section 117. However, if the share of stock received had a fair market value of $70, the loss from the transaction of $10 would not be recognized.

(issued by respondent in October 1943 and applicable to taxable years beginning after December 31, 1941) contain provisions which are identical with Regs. 118, sec. 39.112(g)-4. The provisions of section 112(c)(1) of the 1939 Code were reenacted in substantially identical language in section 351 (b) of the 1954 Code, and respondent's regulations promulgated under the 1954 Code, section 1.351-2(a) restate in substantially identical language what was stated in Regs. 111, sec. 29.112(g)-4, and Regs. 118, Sec. 39.112(g)-4.

Thus, there has been a long-standing and continuous construction of section 112(c)(1) (and the corresponding section in the earlier revenue acts) which has remained unchanged over the years in the face of the several reenactments of the statutory provision, as well as the amendment in the 1934 Act of section 112(g)(1)(B), when there was introduced into subsection (g)(1)(B) the word, "solely," in harmony with the provisions of subsections (b)(2), (b)(3), (b)(4), and (b)(5) which also contained the word, "solely," and contained "solely" for many years. The respondent's regulations, therefore, are deemed to have received the approval of Congress. Helvering v. Winmill, 305 U.S. 79; Lykes v. United States, 343 U.S. 118. Respondent has not offered any explanation for his departure in this case from his long-standing interpretation of section 112(c)(1) set forth in his regulations.

In this circumstance, and since this Court's view of the method to be followed in applying the pro-

visions of section 112(c)(1) is in accord with the respondent's long-standing regulations, we do not find cause for changing our construction of section 112(c)(1), and in this case we conclude that it should be followed.

The respondent's error is that he has seen fit here not to omit the item of cash in determining whether the transaction of petitioner and Foremost involved an exchange of the stock of Supply solely for stock of Foremost within the provisions of section 112(b)(3).

Accordingly it is held, that but for the cash received by petitioner in the transaction involving the exchange of all of the stock of Supply for part of the stock of Foremost, the exchange would have met the "solely" requirement of section 112(g)(1)(B) and fallen within section 112(b)(3). Howard v. Commissioner, supra, p. 948. Therefore, under section 112(c)(1) the gain to petitioner may not be recognized in an amount in excess of $2,984,992.77, which is the net amount of $3,000,000 less allowable expenses.

Recomputations are required under Rule 50 because of concessions or abandonment of the parties in respect to other adjustments.

Decision will be entered under Rule 50.

[Seal]

Served June 12, 1959.

Tax Court of the United States
Washington

Docket No. 69429

GROVER D. TURNBOW and RUTH H. TURNBOW, Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

DECISION

Pursuant to the determinations of the Court, as set forth in its Findings of Fact and Opinion filed June 12, 1959, the respondent has filed recomputations under Rule 50, with which the petitioners agree. Accordingly, it is

Ordered and Decided: That there are deficiencies in income taxes for the taxable years 1952 and 1953 in the amounts of $5,694.30 and $13,404.73, respectively.

[Seal] /s/ MARION J. HARRON,
Judge.

Entered August 31, 1959. Served September 1, 1959.

In the United States Court of Appeals
for the Ninth Circuit

T. C. Docket No. 69429

COMMISSIONER OF INTERNAL REVENUE,
Petitioner on Review,

vs.

GROVER D. TURNBOW and RUTH H. TURNBOW,
Respondents on Review.

PETITION FOR REVIEW

To the Honorable Judges of the United States Court of Appeals for the Ninth Circuit:

The Commissioner of Internal Revenue petitions the United States Court of Appeals for the Ninth Circuit to review the decision of the Tax Court of the United States entered herein on August 31, 1959, pursuant to its opinion filed June 12, 1959 (32 T.C. No. 57), ordering and deciding: "That there are deficiencies in income taxes for the taxable years 1952 and 1953 in the amounts of $5,694.30 and $13,404.73, respectively."

This petition for review is filed and taken pursuant to the provisions of Sections 7482 and 7483 of the Internal Revenue Code of 1954 and applicable amendments thereof.

Jurisdiction

The respondents on review, Grover D. Turnbow and Ruth H. Turnbow, husband and wife, who resided in San Francisco, California, filed joint Fed-

eral income tax returns for the taxable years 1952 and 1953, the years involved herein, with the Collector (now District Director) of Internal Revenue for the First District of California, whose office is located at San Francisco, California, which collection district is within the jurisdiction of the United States Court of Appeals for the Ninth Circuit, wherein this review is sought.

Nature of Controversy

The primary question to be presented to this Court is whether or not Section 112(c)(1) of the Internal Revenue Code of 1939 applies to a transaction in which the respondents received cash and stock in an acquiring corporation in exchange for all the stock in another corporation, which became a subsidiary of the acquiring corporation, so that the taxable gain to be recognized is limited to the amount of cash received.

In a transaction, the details of which are fully stated in the Findings of Fact of the Tax Court herein, the respondent, Grover D. Turnbow, sole stockholder of International Dairy Supply Company (hereinafter referred to as "Supply") on March 31, 1952 transferred all his capital stock (5000 voting shares) to Foremost Dairies, Inc. (hereinafter referred to as "Foremost") for 82,375 shares of Foremost common stock with a fair market value of $15.00 per share, plus $3,000,000.

In the income tax return of the respondents for 1952, they reported long-term capital gain from the transaction in the amount of $2,984,992.77, under

the provisions of Section 112(b)(3) and Section 112(c)(1) of the 1939 Code, which amount is $3,000,000 less expenses incurred in connection with the exchange.

The Commissioner held that the entire gain realized in the transaction of $4,163,691.94 was taxable and, accordingly, increased long-term capital gains reported.

The respondents contended that, in considering whether Section 112(c)(1) applies to the transaction, it is necessary and proper to look to Section 112(b)(3) of the 1939 Code, after omitting the cash payment involved in the transaction. The Commissioner contended that there must be a qualifying reorganization within the meaning of Section 112(g)(1)(B) before Section 112(c)(1) can come into play in so far as Section 112(c)(1) refers to an exchange within the provisions of Section 112(b)(3).

The Tax Court believed that the Commissioner erred in not omitting the item of cash in determining whether the transaction of respondent and "Foremost" involved an exchange of stock of "Supply" solely for stock of "Foremost" within the meaning of the provisions of Section 112(b)(3). The Tax Court, accordingly, held that, but for the cash received by the respondent in the transaction involving the exchange of all of the stock of "Supply" for part of the stock of "Foremost", the exchange would have met the "solely" requirements of Section 112(g)(1)(B) and fallen within Section 112(b)(3); and therefore under Section 112(c)(1) the gain to the respondents may not be recognized

in an amount in excess of $2,984,992.77, which is the net amount of $3,000,000 less allowable expenses.

In reaching its conclusion, the Tax Court followed the Seventh Circuit's decision in Howard v. Commissioner (C.A. 7, 1956) 238 F.2d 943, and its interpretation of the regulations (Reg. 118, Sec. 39.112(g)(4) as set out in its prior opinion in Luther Bonham (1936) 33 B.T.A. 1100.

It is submitted that the Seventh Circuit ignored the explicit provisions of Sections 112(b)(3), 112 (c)(1) and 112(g) of the 1939 Code which require a statutory reorganization independent of Section 112(c)(1). While Section 112(c)(1) refers to Section 112(b)(3), it does not refer to Section 112(g). The Tax Court erroneously interpreted the Commissioner's regulations. Section 39.112(c)-1(c), which refers to the reorganization provisions of Section 39.112(g) assumes the existence of a reorganization before Section 112(c)(1) could apply, as does Section 39.112(g)-(4) which the Tax Court misinterpreted. Also, see Section 39.112(g)-1(c) wherein it is stated that Section 112(b)(3) and 112(c)(1) in so far as it refers to Section 112 (b)(3), does not apply in the absence of a reorganization.

It is also submitted that the method chosen by the Tax Court to apply Section 112(c)(1) to Section 112 (b)(3)in the absence of a transaction which independently qualifies as a Section 112(g) reorganization has no statutory or judicial basis. Furthermore, such method destroys the rigid qualifying requirements for the reorganizations defined in Sec-

tions 112(g)(1)(B) and 112(g)(1)(C), both of which contain the "solely" requirement. The word "solely" contains no leeway. (Helvering v. Southwest Consolidated Corp. (1942) 315 U. S. 194.

It is, accordingly, submitted that the Tax Court erroneously held and concluded that Section 112 (c)(1) is applicable to the transaction herein and that the resulting gain is taxable only in an amount which does not exceed the cash payment (less allowable expenses).

Assignment of Errors

The following assignment of errors is presented as a basis of the review herein:

That the Tax Court of the United States erred:

1. In holding and concluding that the provisions of Section 112(c)(1) of the Internal Revenue Code of 1939 are applicable to the transaction hereinabove set forth.

2. In failing to hold and conclude that the provisions of Section 112(c)(1) of the Internal Revenue Code of 1939 are not applicable to the transaction hereinabove set forth.

3. In holding and deciding that the taxpayers' gain on the transaction is recognized but only in an amount which does not exceed the cash payment.

4. In failing to hold and decide that the entire gain is taxable under Section 112(a) of the Internal Revenue Code of 1939.

5. In failing to hold and decide that there must be a qualifying reorganization within the meaning of Section 112(g)(1)(B) of the 1939 Code before

Section 112(c)(1) can come into play in so far as such section refers to an exchange within the meaning of Section 112(b)(3).

6. In holding and deciding that in construing Section 112(c)(1) and determining the method to be followed in deciding whether it applies to a transaction where stock is exchanged solely for stock, plus money, it is necessary and proper to look to Section 112(b)(3) of the 1939 Code, after omitting the cash payment involved in the transaction.

7. In holding and concluding that its view of the method to be following in applying the provisions of Section 112(c)(1) is in accordance with the Commissioner's long-standing regulations.

8. In holding and deciding that the Commissioner erred in that he did not omit the item of cash in determining whether the transaction of the taxpayer and "Foremost" involved an exchange of stock of "Supply" solely for stock of "Foremost" within the provisions of Section 112(b)(3) of the 1939 Code.

9. In failing to order and decide that there are deficiencies in income tax for the years 1952 and 1953 in the amounts determined by the Commissioner in the notice of deficiency as adjusted by concessions and abandonment by the parties with respect to certain other items.

10. In denying the Commissioner's Request for Review by the Tax Court of a Division Report.

11. In denying the Commissioner's Motion for Reconsideration.

12. In ordering and deciding that there are deficiencies in income tax for the years 1952 and 1953 in the amounts of $5,694.30 and $13,404.73, respectively.

13. In that its decision and opinion are contrary to the law and the regulations and are not supported by substantial evidence of record.

Wherefore, it is accordingly prayed that this Honorable Court review the matters and errors complained of herein, and reverse the decision of the Tax Court of the United States entered herein, and remand the case to the Tax Court for further proceedings.

/s/ CHARLES K. RICE,
Assistant Attorney General,
/s/ HART H. SPIEGEL,
Chief Counsel, Internal Revenue Service,
Counsel for Commissioner of Internal Revenue.

Of Counsel: C. R. Marshall, Special Attorney, Internal Revenue Service.

[Endorsed]: T.C.U.S. Filed November 18, 1959.

[Title of Tax Court and Cause.]

CERTIFICATE

I, Howard P. Locke, Clerk of the Tax Court of the United States, do hereby certify that the documents submitted under this certificate, 1 to 24, in-

clusive, as called for by the Designation for Contents of Record on Review, are the original documents on file in my office, and a true copy of the docket entries as they appear in the official docket of my office, in the case docketed at the above number, in which the respondent in this Court has filed a petition for review.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 1st day of February, 1960.

[Seal] /s/ HOWARD P. LOCKE,
Clerk of the Court.

[Endorsed]: No. 16775. United States Court of Appeals for the Ninth Circuit. Commissioner of Internal Revenue, Petitioner, vs. Grover D. Turnbow and Ruth H. Turnbow, Respondents. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed and Docketed: February 13, 1960.

/s/ FRANK H. SCHMID,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 16775

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

GROVER D. TURNBOW and RUTH L. TURNBOW,
Respondents.

STATEMENT OF POINTS TO BE RELIED UPON

The Commissioner of Internal Revenue, petitioner herein, by his counsel, submits the following statement of points upon which he intends to rely as the basis of his petition for review:

That the Tax Court of the United States erred:

1. In failing to hold and conclude that the provisions of Section 112(b)(3) and (c)(1) of the Internal Revenue Code of 1939 are not applicable to the gain realized by the taxpayers in a transaction whereby they exchanged stock in one corporation for stock in another corporation plus cash.

2. In holding and deciding that the taxpayers' gain on the transaction in question is recognized but only in an amount which does not exceed the cash payment received.

3. In failing to hold and decide that the entire

gain in question is taxable under Section 112(a) of the Internal Revenue Code of 1939.

4. In failing to hold and decide that there must be a qualifying reorganization within the meaning of subsection (g)(1)(B) of Section 112 of the Internal Revenue Code of 1939 before subsection (c)(1) thereof can come into play in so far as it refers to an exchange within the meaning of subsection (b)(3).

5. In failing to order and decide that there are deficiencies in income tax for the years 1952 and 1953 in the amounts determined by the Commissioner in the notice of deficiency as adjusted by concessions and abandonment by the parties with respect to certain other items.

6. In ordering and deciding that there are deficiencies in income tax for the years 1952 and 1953 in the amounts of $5,694.30 and $13,404.73, respectively.

7. In that its decision and opinion are contrary to law and the applicable Treasury Regulations.

Dated: March 16, 1960.

/s/ CHARLES K. RICE,
Assistant Attorney General,
Attorney for Petitioner.

[Endorsed]: Filed March 21, 1960. Frank H. Schmid, Clerk.

[fol. 54]

IN UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

MINUTE ENTRY OF ARGUMENT AND SUBMISSION—October 4, 1960 (omitted in printing).

[fol. 55]

MINUTE ENTRY OF ORDER DIRECTING FILING OF OPINION AND FILING AND RECORDING OF JUDGMENT—December 5, 1960 (omitted in printing).

[fol. 56]

IN UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

No. 16,775

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

GROVER D. TURNBOW and RUTH H. TURNBOW, Respondents.

Upon Petition to Review a Decision of The Tax Court of the United States

OPINION—December 5, 1960

Before: Merrill and Koelsch, Circuit Judges, and Bowen, District Judge

Merrill, Circuit Judge:

This case presents the following question: whether gain realized by a taxpayer upon the transfer of his stock in a wholly owned corporation in consideration for voting stock in another corporation plus cash is recognizable in its entirety or only to the extent of the cash received. The Tax Court, following Howard vs. Commissioner of Internal Revenue, 7 Cir., 1956, 238 F. 2d 943, has ruled that the gain is

recognizable only to the extent of the cash received. Grover D. Turnbow, 32 T. C. 646. We have concluded that this was error and that the gain is recognizable in its entirety.

The taxpayer, Turnbow, was the sole stockholder of International Dairy Supply Company, a Nevada corporation which had its principal place of business in San Francisco, California. In 1952, the taxpayer transferred his stock in that company to Foremost Dairies, Inc., a New York corporation which had its principal place of business in Jacksonville, Florida. This transfer was in exchange for 82,375 shares of the common stock of Foremost and [fol. 57] $3,000,000.00 cash, so-called "boot." The Foremost shares were of a value of $1,235,625.00. Thus the shares constituted 29% of the total consideration received, while the boot constituted 71%.

The taxpayer reported a capital gain on the transaction limited to the $3,000,000.00 cash boot, less expenses which by agreement he had undertaken to assume. The Commissioner determined that the entire gain on the transaction was taxable, establishing that gain at $4,163,691.94. Tax deficiencies for the years 1952 and 1953 in the amounts, respectively, of $264,037.43 and $14,786.26 were determined.

The taxpayer petitioned the Tax Court for review. That court held that gain on the transaction should be limited to the cash boot. The deficiencies were disallowed. The Commissioner has petitioned this court for review.

The problem presented involves construction of § 112 of the Internal Revenue Code of 1939, which deals with recognition of gain or loss.

Section 112(a) sets forth the general rule that "upon the sale or exchange of property the entire amount of gain or loss * * * shall be recognized, except as hereinafter provided in this section."

Among the exceptions specified, § 112(b) deals with exchanges solely in kind, and § 112(b)(3) deals with exchanges of stock for stock on reorganization. It provides:

> "No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization."

The term "reorganization," as used in § 112(b)(3), is defined in § 112(g)(1), which, as amended in 1943, provides:

> "The term 'reorganization' means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, or (C) the acquisition by one corporation, in exchange solely for all or a par. of its voting stock, of [fol. 58] substantially all the properties of another corporation, but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded, or (D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, or (E) a recapitalization, or (F) a mere change in identity, form, or place of organization, however, effected."

In this case we are concerned with the definition set forth in Clause (B) of § 112(g)(1). Our discussion also deals with the definition set forth in Clause (C). Today these types of reorganization are known to the tax bar as (B) and (C) reorganizations and we shall take advantage of this terminology.

Section 112(c) is the section upon which the taxpayer relies for his right to limit recognition of gain to the cash boot. As amended in 1943, § 112(c)(1) provides:

> "If an exchange would be within the provisions of subsection (b)(1), (2), (3), or (5), or within the provisions of subsection (1), of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph or by subsection (1) to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but

in an amount not in excess of the sum of such money and the fair market value of such other property."

The dispute before us is as to the method to be followed in applying § 112(c) to the facts of a case. The Tax Court purported to follow its earlier decision upon this problem in Luther Bonham, 1936, 33 B. T. A. 1100, 1103-1104. It quoted that opinion (supplying its own emphasis) as follows:

"It is necessary therefore to determine whether or not the exchange of * * * stock for * * * stock *would be* within the provisions of subsection (b)(3) *if the item of* [fol. 59] *cash had been omitted* and only * * * stock had been received in exchange for * * * stock."

Howard vs. Commissioner of Internal Revenue, supra at page 948, was also quoted to the following effect:

"In the instant case, *but for* the cash received in exchange for * * * common stock of Binkley, the transaction would have met the 'solely' requirement of section 112(g)(1)(B) and fallen within the scope of section 112(b)(3). To the extent that 'boot' was received, gain would be recognized under our interpretation of section 112(c)(1)."

Applying this method to the case at bar, the taxpayer reasons: but for the cash received, the transaction—solely stock for stock—would have met the "solely" requirements of both §§ 112(b)(3) and 112(g)(1)(B) and fallen within the nonrecognition provision of § 112(b)(3). Therefore, he says, under § 112(c) the gain to be recognized is limited to the amount of the cash received.

The Commissioner contends that § 112(b)(3) requires an actual and not a hypothetical reorganization before nonrecognition can result; that petitioner's method assumes the absence of boot not only to determine whether § 112(b)(3) would apply but also to determine whether the § 112(g)(1)(B) definition would apply; that this does violence to § 112(b)(3), which expressly contemplates the existence of a reorganization.

The method of applying § 112(c), advocated by the Commissioner, is to ascertain first whether a reorganization

exists under § 112(g)(1). If it does, then and only then can the nonrecognition provisions of § 112(b)(3) become applicable. If it does not, § 112(b)(3) cannot apply. Only when § 112(b)(3) applies, can § 112(c) operate to modify its consequences.

Applying this method to the case at bar, the Commissioner reasons that, since the presence of boot precludes a (B) reorganization, § 112(b)(3) cannot apply and the gain is subject to taxation under § 112(a). Under the Commissioner's construction, (B) and (C) reorganizations are forever excluded from the operation of § 112(c). The other types of reorganizations specified in § 112(g)(1), however, do remain subject to the operation of § 112(c).

[fol. 60] Upon this dispute, legislative history supports the Commissioner's position.

Prior to 1934, there were no (B) or (C) reorganizations as such.[1] Section 112(i) of the Revenue Act of 1932 (the prior analogous section to § 112(g)(1) of the 1934 Act) read in pertinent part:

> "The term 'reorganization' means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation)."

The provisions of §§ 112(b)(3) and 112(c), however, existed in substantially their present form.

The reasons for the 1934 amendment of § 112(g)(1) are clearly disclosed by congressional reports and discussion. The House Ways and Means Committee Report, H. Rep. No. 704, 73d Congress, 2d Session 13 (1934) states:

> "The reorganization provisions have been in effect for many years, having been adopted in substantially their present form in 1924. They state in detail how each step of a reorganization should be treated for tax pur-

[1] Even the 1934 amendment did not separate (B) and (C) reorganizations. Both were dealt with under Clause (B). It was not until the Internal Revenue Code of 1939 that the separation occurred which has given rise to today's terminology.

poses. The policy was adopted of permitting reorganizations to take a wide variety of forms, without income-tax liability. As a result, astute lawyers frequently attempted, especially during the prosperous years, to take advantage of these provisions by arranging in the technical form of a reorganization, within the statutory definition, what were really sales."

A letter from the Secretary of the Treasury, which appears in the Congressional Record, 78 Cong. Rec. 2512 (1934) states:

"Exchanges and reorganizations. The Treasury regards it as desirable that business readjustments be permitted without tax consequences in cases where the stockholders in the enterprise are retaining their [fol. 61] interests without the receipt of cash and the essential continuity of the business is being preserved. On the other hand, the Treasury has suffered a considerable loss of revenue in recent years through the adroitness of attorneys in planning sales in such a way as to come within the scope of the reorganization provisions. The bill revises the definition of reorganization in order to eliminate serious loopholes in this provision, while legitimate exchanges and reorganizations may still be carried out without the realization of gain or loss. In the opinion of the Department, a considerable saving in revenue will result from these amendments without the injurious effects to business which would have been caused by a complete elimination of these provisions."

A subcommittee of the House Ways and Means Committee, studying the revision of the revenue act, was sufficiently exercised over avoidance practices to give serious consideration to the advisability of eliminating completely the provisions governing reorganization exchanges. H. Rep., December 4, 1933, 73d Congress, 2d Session, 8-9 (1933). However, the House Ways and Means Committee, in its report, stated:

"The committee decided that, under present conditions, the wiser policy is to amend the provisions drastically

to stop the known cases of tax avoidance, rather than to eliminate the sections completely." H. Rep. No. 704, 73d Congress, 2d Session, 13 (1934).

The House committee's solution was to eliminate from the definition of reorganization, as it then appeared in Clause (A), the parenthetical phrase following the words "merger or consolidation."

Had this solution been adopted, there would have been no (B) or (C) reorganizations and § 112(c) obviously could have no reference to such transactions.

The Senate Finance Committee reported, S. Rep. No. 558, 73d Congress, 2d Session, 16 (1934):

"Your committee is in complete agreement with the purposes of the House bill which aim at tax avoidance [fol. 62] schemes in this connection. However, some modifications are recommended in order to bring about a more uniform application of the provisions in all 48 of the States. Not all of the States have adopted statutes providing for mergers or consolidations; and, moreover, a corporation of one State cannot ordinarily merge with a corporation of another State. The committee believes that it is desirable to permit reorganizations in such cases, with restrictions designed to prevent tax avoidance. Consequently, the committee recommends the insertion in the House bill of an addition to the definition of the term 'reorganization' as follows: * * *"

Then follows the Clause (B) definition which was eventually incorporated into § 112(g)(1) of the 1934 act.

Emphasizing its views that the tax avoidance problems would be met, the report states at page 17:

"It will be noted that the proposed amendment requires that * * * the acquisition, whether of stock or of substantially all the properties, must be in exchange solely for the voting stock of the acquiring corporation."

It is clear from this history that, with specific abuses in mind, Congress sought to eliminate them by requiring that,

for an acquisition to qualify for the tax advantages of a reorganization, it must be in exchange solely for voting stock.

With reference to this requirement the Supreme Court has stated in Helvering vs. Southwest Consolidated Corporation, 1941, 315 U.S. 194, 198:

> "But clause B of § 112(g)(1) of the 1934 Act effects an important change as respects transactions whereby one corporation acquires substantially all of the assets of another. See S. Rep. No. 558, 73d Cong., 2d Sess., Committee Reports, Revenue Acts 1913-1938, pp. 598-599. The continuity of interest test is made much stricter. See Paul, Studies in Federal Taxation (3d Series), pp. 36-41. Congress has provided that the assets of the transferor corporation must be acquired in exchange 'solely' for 'voting stock' of the transferee. 'Solely' leaves no leeway. Voting stock plus some other consideration does not meet the statutory requirement. [fol. 63] See Hendricks, Developments in the Taxation of Reorganizations, 34 Col. L. Rev. 1198, 1202-1203."

Certainly it could not have been intended by Congress that this result would be frustrated at birth by the already existing provisions of § 112(c); yet such would seem to be the effect of the taxpayer's construction.

The Commissioner's construction seems supported by subsequent congressional action. If (B) reorganizations can hypothetically exist notwithstanding boot, the same would apply to today's (C)-type reorganizations, which also were created by the 1934 amendments.

> "• • • the acquisition by one corporation, in exchange solely for all or a part of its voting stock; • • • of substantially all the properties of another corporation • • •." § 112(g)(1)(B) of the Revenue Act of 1934.

Yet, in 1939, Congress saw fit to amend the definition of (C) reorganizations by providing:

> "• • • but in determining whether the exchange is solely for voting stock the assumption by the acquiring cor-

> poration of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded * * * ." § 112(g)(1)(C) of the Internal Revenue Code of 1939.

In § 368(a)(2)(B) of the Internal Revenue Code of 1954, the definition was further amended to provide that only 80% of the assets of the acquired corporation need be obtained in exchange for voting stock; that boot could, without defeating reorganization, be the consideration for assets above 80%. Under the taxpayer's construction, neither of these amendments was necessary. That Congress felt it necessary so to amend the section indicates that the Commissioner's construction reflects the true congressional intent and understanding.

The taxpayer refers us to a point emphasized in Howard vs. Commissioner of Internal Revenue, supra. Section 112 (e) is the counterpart of § 112(c), the latter dealing with recognition of gains and the former with recognition of [fol. 64] losses. Section 112(e) has remained virtually unchanged since its original enactment as § 203(f) of the Revenue Act of 1924. It provides:

> "If an exchange would be within the provisions of subsection (b)(1) to (5), inclusive, or (10), or within the provisions of subsection (1), of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized."

Howard points out that if the presence of boot results in recognition of gains it likewise results in recognition of losses; that a taxpayer desiring that a loss be recognized might convert what otherwise would be a legitimate reorganization into a sale by the payment of a trifling amount of cash; that such a construction would thus defeat the 1924 legislative intent in enacting § 112(e).

It would appear, however, that Congress in 1934 was aware that attempts might be made under the proposed

amendment to secure recognition of losses notwithstanding actual continuity of interest. The House Ways and Means Committee, as we have noted, recommended that the "acquisition" type of transaction (the forerunner of today's (B) and (C) reorganizations) be completely eliminated from the definition or reorganization. At the same time the report stated:

> "Furthermore, the retention of the other reorganization provisions will prevent large losses from being established by bondholders and stockholders who receive securities in a newly reorganized enterprise which are substantially the same as their original investments." H. Rep. No. 704, 73d Congress, 2d Session, 14 (1934).

Thus it would appear that in the judgment of Congress the danger of tax avoidance (through securing recognition of losses notwithstanding continuity of interest) was avoided by the probability that the acquisitions resulting in loss could be treated as reorganizations under the remaining provisions of § 112(g)(1).[2]

[fol. 65] Whether this judgment was sound apparently still remains to be tested. However, Congress would seem

---

[2] The judgment of Congress would also seem to have taken into consideration the apparent lack of effectiveness of § 112(e) in preventing loss taking in corporation exchange transactions. The report of the subcommittee of the House Ways and Means Committee stated in H. Rep., December 4, 1933, 73d Congress, 2d Session 37-42 (1933):

> "The statute provides that upon sale or exchange of property, the entire amount of gain or loss shall be recognized with certain exceptions. The exceptions are the exchange and reorganization provisions already referred to. If a taxpayer desires to take a loss, it is easy to arrange a transaction falling without the exceptions. On the other hand, if it is desired to pay no tax on the gain, the transaction can be so arranged as to come within the exception. In addition, losses from the sale or exchange of stocks and bonds are limited, to a large extent, to gains from such sales or exchanges so in many cases a stock or bond loss, even if recognized, could not be utilized by the taxpayer."

This quote also appears at: Hearings before the House Committee on Ways and Means on the 1934 Revenue Bill, 73d Congress, 2d Session 60 (1934).

to have weighed the desirable features of the proposed amendment (as to gains) against its undesirable potentialities (as to losses). For us to permit the possibility of tax avoidance under § 112(e), to control our construction of § 112(c), would be to overrule the apparent judgment of Congress upon this very question.

The Tax Court opinion in this case points out that the Commissioner's regulations are deemed to have received the approval of Congress (citing Lykes vs. United States, 1951, 343 U.S. 118; Helvering vs. Winmill, 1938, 305 U.S. 79) and places reliance upon the Commissioner's regulations, 118, § 39.112(g)-4. In our view, this section casts little light on the problem. On the other hand, § 39.112(g)-1(c) of the regulations lends support to the Commissioner's position. It provides in part:

> "From its context the term 'a party to a reorganization' can only mean a party to a transaction specifically defined as a reorganization by section 112(g). • • • The provisions of the Internal Revenue Code referred to in this paragraph [this includes § 112(c)] are inapplicable unless there is a plan of reorganization. A plan of reorganization must contemplate the bona fide execution of one of the transactions specifically described as a reorganization in section 112(g) and for [fol. 66] the bona fide consummation of each of the requisite acts under which nonrecognition of gain is claimed."

We conclude that, if the "solely for voting stock" requirement of (B) and (C) reorganizations is to be given the effect intended by Congress, § 112(c) cannot operate to render a stock-plus-boot acquisition a (B) or (C) reorganization through a disregard of the existence of boot. In the case before us, then, the existence of boot prevents § 112(g)(1)(B) from applying; since no reorganization exists, § 112(b)(3) cannot apply; § 112(c) is then also inapplicable.

Reversed and remanded with instructions that the deficiencies determined by the Commissioner be reexamined in the light of this opinion.

[File endorsement omitted]

[fol. 67]

[File endorsement omitted]

IN UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

No. 16,775

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

GROVER D. TURNBOW and RUTH H. TURNBOW, Respondents.

JUDGMENT—Filed and Entered December 5, 1960

Upon petition to review a decision of the Tax Court of the United States.

This cause came on to be heard on the Transcript of the Record from the Tax Court of the United States, and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this Court that the decision of the said Tax Court of the United States in this cause be, and hereby is reversed, and that this cause be, and hereby is remanded to the said Tax Court of the United States with instructions that the deficiencies determined by the Commissioner be reexamined in the light of the opinion of this Court.

[fol. 68] Clerk's Certificate to foregoing transcript (omitted in printing).

[fol. 69]

SUPREME COURT OF THE UNITED STATES

No. 777—October Term, 1960

GROVER D. TURNBOW, ET AL., Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE

ORDER ALLOWING CERTIORARI—May 15, 1961

The petition herein for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit is granted, and the case is transferred to the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

LIBRARY

Office Supreme Court, U.S.
FILED
MAR 2 1961
JAMES R. BROWNING, Clerk

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1960

No. 60

GROVER D. TURNBOW and RUTH H. TURNBOW,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI to the United States Court of Appeals for the Ninth Circuit

FRANCIS R. KIRKHAM,
HARRY R. HORROW,
FRANCIS N. MARSHALL,
WHITCOMB J. McFARLAND,
Standard Oil Building,
San Francisco 4, California,
Attorneys for Petitioners.

PILLSBURY, MADISON & SUTRO,
Standard Oil Building,
San Francisco 4, California,
STACY H. DOBRZENSKY,
1730 First Western Building,
Oakland 12, California,
Of Counsel.

OPINIONS BELOW

The Findings of Fact and Opinion of the Tax Court (R. 29-42), printed in Appendix B, infra, pages iv-xvi, are reported at 32 T.C. 646. The opinion of the Court of Appeals (R. 56-66), printed in Appendix B, infra, pages xviii-xxx, has not yet been reported.

JURISDICTION

The judgment of the Court of Appeals was entered on December 5, 1960 (R. 66). The jurisdiction of this Court is invoked under section 1254 of Title 28 of the United States Code.

QUESTION PRESENTED

Whether, under § 112(c)(1) of the Internal Revenue Code of 1939, the gain to a taxpayer who has exchanged all of the voting stock of one corporation for a part of the voting stock of another corporation plus cash is recognized in the year of the transaction only to the extent of the cash, postponing recognition of the gain (if any) on the stock received until it becomes the subject of some later taxable transaction.

STATUTES INVOLVED

The case directly concerns the interpretation of § 112(c)(1) of the Internal Revenue Code of 1939 (53 Stat. 39), which provides in pertinent part:

> "If an exchange would be within the provisions of subsection (b) * * (3) * * of this section if it were

not for the fact that the property received in exchange consists not only of property permitted by such paragraph * * to be received without the recognition of gain, but also of * * money, then the gain * * to the recipient shall be recognized, but in an amount not in excess of * * such money * *."[1]

This statute and the pertinent portions of other statutes involved are set out in Appendix A, infra, pages i-iii.

STATEMENT OF THE CASE

The facts are not in dispute. As the Tax Court found (R. 36):

The taxpayer[2] owned all 5000 shares of the outstanding stock, all of which was voting stock, of International Dairy Supply Company, a Nevada corporation (hereinafter called "Supply")[3] (R. 30, 31). Supply's business, in the main, was furnishing reconstituted milk and milk products to the Armed Forces of the United States, located outside the country, under contracts with the United States (R. 30-31).

---

[1]These provisions are retained in substantially the same form in the Internal Revenue Code of 1954, § 356.

[2]References to the taxpayer in this petition are to Grover D. Turnbow, inasmuch as his wife, Ruth H. Turnbow, is a party only because she filed a joint return with her husband for the taxable year involved.

[3]The taxpayer owned interests in two other corporations, which also entered into the transactions herein described. However, since there is now no issue in any way involving these other interests, reference to them is hereinafter omitted.

Foremost Dairies, Inc. (hereinafter called "Foremost"), was a New York corporation engaged in the business of processing and distributing milk, cream, and other dairy products (R. 30).

In 1951, Foremost and the taxpayer entered into an agreement under which Foremost was to acquire all of the stock of Supply in what was intended to be a tax-free reorganization (R. 32). Upon completion of preliminary negotiations, a supplemental agreement, called "Amendatory Agreement," was executed by Foremost and the taxpayer on February 11, 1952. The Amendatory Agreement included, inter alia, the reorganization plan (R. 32).

Under the reorganization plan Foremost was to acquire from the taxpayer all of the capital stock of Supply, and the taxpayer was to receive in exchange 82,375 shares of the common stock of Foremost (a minority interest), plus $3,000,000. Supply was thereby to become a wholly owned subsidiary of Foremost; it was to continue in the operation of its business. It was not to make any distribution to its shareholders in pursuance of the plan of reorganization or otherwise (R. 32-33).

The reorganization plan also provided for many changes in the management of both Foremost and Supply, with Turnbow to be president and general manager of Supply and also a director and chairman of the executive committee of Foremost and general manager of its Western and International Division, and with the right to name three of Supply's six directors and two of Foremost's directors (R. 33-34).

The terms of the Amendatory Agreement were carried out (R. 34).

On March 3, 1952, the exchange of the stock of Supply for stock of Foremost was consummated, and the taxpayer received 82,375 shares (then having a fair market value of $15 per share) of the common stock of Foremost and $3,000,000 cash, in exchange for all of the capital stock of Supply. Since his expenses in connection with the exchange were $15,007.23, the net amount of the cash he received was $2,984,992.77 (R. 34-35).

In his 1952 income tax return the taxpayer reported long-term capital gain from the above-described transaction in the amount of $2,984,992.77 (R. 35).

The Commissioner determined that the recognized gain from the transaction should be increased by $1,178,699.17 (the value of the Foremost stock at the date of the exchange less the cost basis of the stock of Supply, with certain adjustments not material here) (R. 35-36).

On the taxpayer's petition for redetermination, under § 272 of the Internal Revenue Code of 1939 (53 Stat. 82), the Tax Court held that the recognized gain on the transaction was limited to the cash "boot" (R. 29-42).

On petition for review under § 7482 of the Internal Revenue Code of 1954, the court below reversed the Tax Court (R. 56-66). Recognizing that the Tax Court had expressly followed the prior decision of the Court of Appeals for the Seventh Circuit in *Howard* v. *Commissioner of Internal Revenue* (7 Cir. 1956) 238 F.2d 943, and its own prior decision in *Luther Bonham* (1936) 33 B.T.A. 1100, on the identical problem (R. 56, 58), the court below refused to follow those decisions. It held that since the transaction *with the cash included* was not a